

Message Text

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ACTION ARA-14

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FM AMEMBASSY BUENOS AIRES

TO SECSTATE WASHDC 2705

C O N F I D E N T I A L SECTION 1 OF 2 BUENOS AIRES 7661

E.O. 11652: GDS

TAGS: PGOV, ECRP, US, AR, ECON

SUBJECT: PARM ANNUAL POLICY AND RESOURCES ASSESSMENT
FOR ARGENTINA

REF: (A) STATE 217725 (B) BUENOS AIRES 7512

1. IN ACCORDANCE WITH PARAGRAPH 6 REF A), THE EMBASSY HAS
PREPARED THE FOLLOWING REPORT FOR POSSIBLE INCLUSION IN
THE PARM:

2. ECONOMIC SITUATION - ARGENTINA

A. IN MARCH OF 1976, ARGENTINA'S ECONOMIC SITUATION UNDER
THE PERONIST REGIME WAS DETERIORATING RAPIDLY, PRODUCTION
WAS DECLINING, INFLATION WAS ACCELERATING RAPIDLY, THE
TRADE DEFICIT WAS HUGE AND ARGENTINA FACED A THREAT OF AN
EXTERNAL DEBT MORATORIUM. UNDER THE LEADERSHIP OF MINISTER
OF ECONOMY MARTINEZ DE HOZ, THE NEW GOVERNMENT SET OUT TO
TACKLE THESE IMMEDIATE PROBLEMS AND EMBARKED ON A NEW
DEVELOPMENT STRATEGY. IN THE PLACE OF THE PERONIST POPULIST
PROGRAMS TO REDISTRIBUTE INCOME AND EXPAND STATE ACTIVITIES,
THE GOVERNMENT SOUGHT TO ESTABLISH A FREE MARKET ECONOMY.
THE GOVERNMENT PROGRAM EMPHASIZED AN EXPORT-ORIENTED
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GROWTH STRATEGY BUILT AROUND RECOVERY OF THE AGRICULTURAL
SECTOR. MAJOR OBJECTIVES WERE: REDUCTION OF THE FISCAL
DEFICIT, RATIONALIZATION OF PUBLIC SECTOR ACTIVITIES,
MONETARY DISCIPLINE, AND THE EXPANSION OF PRIVATE
INVESTMENT, INCLUDING THAT OF FOREIGN ORIGIN.

B. THE ECONOMIC PROGRAM HAS MADE CONSIDERABLE PROGRESS

IN TURNING THE ECONOMY AROUND, ALTHOUGH SERIOUS PROBLEMS CONTINUE TO EXIST. THE MOST NOTABLE ACHIEVEMENTS HAVE BEEN REGISTERED IN THE EXTERNAL SECTOR. FROM VIRTUAL BANKRUPTCY IN MARCH 1976, ARGENTINA'S RESERVES STOOD AT \$2.9 BILLION AT THE END OF AUGUST, 1977 -- AN ALL-TIME RECORD. ARGENTINA'S STRONG RESERVE POSITION REFLECTS ARGENTINA'S EXTRAORDINARY EXPORT PERFORMANCE, ATTRIBUTABLE IN LARGE PART TO A RECORD EXPORTABLE SURPLUS OF GRAINS AND OILSEEDS AND TO A MORE REALISTIC EXCHANGE RATE POLICY. ARGENTINA'S BALANCE TRADE SURPLUS IN THE FIRST SEMESTER OF 1977 WAS \$1.06 BILLION, WITH EXPORTS OF \$2.87 BILLION AND IMPORTS OF \$1.8 BILLION. THE OUTLOOK IS FOR A SMALLER SURPLUS IN THE SECOND HALF OF 1977, BRINGING THE FULL-YEAR TRADE SURPLUS TO AROUND \$1.3 BILLION (\$5 BILLION IN EXPORTS AND \$3.7 BILLION IN IMPORTS).

C. ON THE DOMESTIC FRONT, PRODUCTION HAS TURNED UPWARD ONCE AGAIN, WITH FULL-YEAR 1977 GDP GROWTH NOW PROJECTED AT OVER 4 PERCENT. BENEFITING FROM GOOD CLIMATIC CONDITIONS, AND RESPONDING TO THE GOVERNMENT'S LIBERALIZATION OF CONTROLS AND PRICING IN ACCORDANCE WITH INTERNATIONAL LEVELS, THE AGRICULTURE SECTOR PRODUCED A BUMPER GRAIN AND OILSEED CROP - 34 PERCENT MORE THAN THE PREVIOUS SEASON. THE SITUATION IN THE MANUFACTURING SECTOR SHOWED IMPROVEMENT OVERALL BUT PERFORMANCE WAS CONFIDENTIAL

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MIXED. INDUSTRIES PRODUCING CONSUMER GOODS FOR THE DOMESTIC MARKET ARE STILL DEPRESSED. ON THE OTHER HAND, INDUSTRIES PRODUCING INPUTS FOR THE AGRICULTURAL SECTOR OR CAPITAL GOODS FOR THE INDUSTRIAL SECTOR ARE DOING WELL AND IN SOME INSTANCES EVEN EXPANDING PRODUCTION CAPACITY. CONSTRUCTION ACTIVITY HAS RISEN SHARPLY, REFLECTING MAINLY INCREASED EXPENDITURES FOR PUBLIC WORKS PROJECTS AND FOR LUXURY PRIVATE HOUSING. ALL THINGS CONSIDERED, THE OUTLOOK FOR 1978 IS FOR EVEN GREATER GDP GROWTH, DESPITE AN EXPECTED DOWNTURN IN AGRICULTURAL PRODUCTION AS A RESULT OF PRICE AND CLIMATIC FACTORS.

D. INFLATION CONTINUES TO BE ARGENTINA'S MOST PRESSING ECONOMIC PROBLEM. ALTHOUGH INFLATION HAS BEEN GREATLY REDUCED FROM 1975 AND 1976 LEVELS, THE RISE IN THE CONSUMER PRICE INDEX FOR FULL-YEAR 1977 IS EXPECTED TO BE IN THE RANGE OF 140-150 PERCENT -- CURRENTLY THE HIGHEST RATE OF INFLATION IN THE WORLD. TO COMBAT INFLATION, THE GOA HAS ADOPTED A VARIETY OF MEASURES, INCLUDING WAGE CONTROLS, REDUCTION OF THE BUDGET DEFICIT, DECELERATION OF THE EXPANSION OF THE MONEY SUPPLY, PRICE

CONTROLS ON LEADING FIRMS, AND A SELECTIVE REDUCTION IN
TARIFFS IN AN EFFORT BOTH TO ENCOURAGE EFFICIENCY AND
TO ESTABLISH A CEILING ON DOMESTIC PRICES BY SUBJECTING
LOCAL PRODUCTS TO FOREIGN COMPETITION. SINCE THESE
MEASURES MET WITH LESS THAN DESIRED SUCCESS IN THE
FIRST HALF OF 1977, THE GOA HAS ADOPTED A PARTICULARLY
TIGHT MONETARY POLICY FOR THE REMAINDER OF THE YEAR
WHICH HAS DRIVEN UP INTEREST RATES TO A LEVEL WHICH MAY
RESULT IN THE BANKRUPTCY OF SOME SMALL FIRMS THAT HAD
BECOME DEPENDENT ON NEGATIVE INTEREST RATES. THE GOA
WILL ALSO PREPARE AN EVEN MORE AUSTERE BUDGET FOR 1978,
BRINGING THE DEFICIT DOWN FROM AN EXPECTED 3 PERCENT OF
GDP IN 1977 TO 1 PERCENT OF GDP IN 1978.

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E. THE GOA'S "PRAGMATIC-GRADUALIST" POLICY HAS SOUGHT
TO MINIMIZE THE SOCIAL COSTS OF ITS STABILIZATION
PROGRAM AND ACCEPTS A SUBSTANTIAL REDUCTION IN REAL WAGES
IN RETURN FOR RELATIVELY LOW UNEMPLOYMENT (3-4 PERCENT). IN
ACUTUALITY, WAGE CONTROLS HAVE ONLY BEEN ENFORCED WITH ANY
DEGREE OF STRICTNESS AMONG GOVERNMENT WORKERS (EVEN IN THE
GOVERNMENT, ONE OCCASIONALLY HEARS OF ENGAGING PROFESSIONALS ON
A CONSULTANT BASIS TO BYPASS SALARY RESTRAINTS). IN THE

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PRIVATE SECTOR, HOWEVER, FIRMS WHICH CAN AFFORD TO DO

SO HAVE BEEN PAYING WORKERS WAGES SUBSTANTIALLY ABOVE THOSE APPROVED OFFICIALLLY, EITHER TO AVOID LABOR UNREST OR, AS IS BECOMING INCREASINGLY MORE PREVALENT, TO KEEP OR ATTRACT WORKERS IN SHORT SUPPLY. WHILE THE GOA POLICY MAY HAVE SUCCEEDED IN KEEPING SOCIAL COSTS LOW, DISCONTENT WITH THE GOA'S LABOR POLICY, PARTICULARLY AMONG WORKERS FOR THE GOVERNMENT OR FOR DEPRESSED INDUSTRIES, HAS INCREASED AS THE RATE OF INFLATION HAS TURNED UPWARD. LABOR DISSATISFACTION AND DIFFICULTIES EXPERIENCED BY SMALL, INEFFICIENT FIRMS, WILL INCREASE POLITICAL PRESSURES ON THE GOVERNMENT FOR A LESS AUSTERE ECONOMIC POLICY. AS MINISTER OF ECONOMY MARTINEZ DE HOZ HAS ADMITTED, THE LAST FOUR MONTHS OF 1977 ARE LIKELY TO BE TROUBLESOME FOR HIM.

3. EXTERNAL DEBT

AT YEAR-END 1976, ARGENTINA'S TOTAL EXTERNAL DEBT (INCLUDING UNDISBURSED) WAS \$9.7 BILLION, OF WHICH \$3 BILLION WAS OWED TO THE U.S. WITH EXIMBANK'S EXPOSURE TOTALING ROUGHLY \$500 MILLION, U.S. COMMERCIAL BANK AND U.S. SUPPLIER CREDITS TO ARGENTINA AMOUNT TO AROUND \$2.5 BILLION. ARGENTINA'S EXTERNAL DEBT IS MANAGEABLE
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AND, WITH RESERVES AT AN ALL-TIME HIGH, NO DEBT-SERVICING PROBLEMS ARE FORESEEN OVER THE NEAR FUTURE. ACCORDING TO THE IMF, TOTAL PUBLIC DISBURSED DEBT STOOD AT U.S. \$3.3 BILLION AT THE END OF MARCH 1977. THE PUBLIC DEBT SERVICE RATIO DECLINED FROM 22.5 PERCENT IN 1976 TO AROUND 18.5 PERCENT IN 1977, REFLECTING BOTH AN IMPROVEMENT IN EXPORT EARNINGS AND REPLACEMENT OF SOME OF ARGENTINA'S SHORT-TERM DEBT WITH DEBT HAVING LONGER MATURITY.

4. TRADE ISSUES

A. TRADE DIFFERENCES BETWEEN THE U.S. AND ARGENTINA ARE RELATIVELY MINOR BUT ARE OFTEN RAISED IN BILATERAL DISCUSSIONS. HISTORICALLY, THE MAIN BILATERAL TRADE ISSUE HAS BEEN THE U.S. SANITARY RESTRICTION ON IMPORTS OF ARGENTINE CHILLED OR FRESH MEAT BECAUSE HOOF AND MOUTH DISEASE IS ENDEMIC IN ARGENTINA. THE ARGENTINES HAVE EXPRESSED CONCERN OVER THE PERSISTENT DEFICIT IN THEIR TRADE WITH THE U.S. AND CALLED FOR INCREASED ACCESS OF ARGENTINE PRODUCTS TO THE U.S. MARKET. THEY HAVE OBJECTED TO U.S. QUOTA RESTRICTIONS ON CERTAIN KINDS OF PRODUCTS, SUCH AS SPECIALTY STEELS, AND PWDERED MILK AND OVER POSSIBLE U.S. COUNTERVAILING DUTIES ON IMPORTS OF NON-RUBBER FOOTWEAR AND LEATHER WEARING APPAREL. THEY WOULD LIKE TO HAVE THE GSP LIST EXPANDED, THE

INCLUSION OF PRODUCTS ON THE LIST MADE MORE STABLE, AND THE DOLLAR LIMIT ON EXPORTS TO QUALIFY FOR GSP TREATMENT ELIMINATED. THE FOREIGN MINISTRY HAS PROPOSED THE REESTABLISHMENT OF A HIGH LEVEL MIXED BILATERAL COMMISSION TO ATTEMPT TO SETTLE SOME OF THESE DIFFERENCES.

B. IN MULTILATERAL FORA, THE GOA POSITION AT THE MTN TRADE NEGOTIATIONS IN GENEVE IS TROUBLING US AT PRESENT.
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THE ARGENTINES ARE ADHERING TO THE LDC LINE THAT THEY CANNOT OFFER ANY CONCESSIONS, EVEN IN PRINCIPLE, UNTIL THE NEGOTIATIONS ARE COMPLETE AND THEY CAN DETERMINE WHAT BENEFITS THEY WILL RECEIVE. WE ARE PRESSING THE ARGENTINES TO OFFER CONCESSIONS BEFOREHAND. HOWEVER, IN OTHER MULTILATERAL AREAS, SUCH AS IN TALKS ON SUGAR AND WHEAT AGREEMENTS, THE ARGENTINES HAVE TENDED TO SUPPORT OUR POINT OF VIEW.

5. INVESTMENT DISPUTES

A. UNDER THE VIDELA GOVERNMENT, CONSIDERABLE PROGRESS HAS BEEN MADE IN SETTLING INVESTMENT DISPUTES BETWEEN U.S. COMPANIES AND THE PRECEDING PERONIST REGIME. THE DISPUTES INVOLVED EITHER ABROGATION OF CONTRACTS OR NATIONALIZATION WITHOUT ADEQUATE COMPENSATION. THE SETTLEMENTS INCLUDE: \$60 MILLION IN COMPENSATION TO ITT FOR THE ABROGATION OF A CONTRACT; THE RETURN OF SHARES IN NATIONALIZED LOCAL BANKS TO MORGAN GUARANTY AND CHASE MANHATTAN; AND \$19 MILLION IN COMPENSATION AND THE RETURN OF NATIONALIZED RETAIL OUTLETS TO ESSO.

B. THE ONLY MAJOR UNRESOLVED INVESTMENT DISPUTE INVOLVES DELTEC. THE GOA TOOK OVER ALL OF DELTEC'S ASSETS IN ARGENTINA AS A RESULT OF THE BANKRUPTCY OF SWIFT, ITS ARGENTINE MEATPACKING SUBSIDIARY. THE VIDELA GOVERNMENT HAS PROCEEDED TO SELL SWIFT ASSETS TO PAY OFF SWIFT CREDITORS, BUT HAS ALSO PRESENTED ITS OWN CLAIM FOR REPAYMENT, WITH INDEXATION OF FUNDS ADVANCED TO SWIFT WHILE LATTER WAS UNDER GOVERNMENT MANAGEMENT. DELTEC CLAIMS THAT THE GOA DEMAND FOR REPAYMENT IS UNWARRANTED BECAUSE THE GOA ADVANCES WERE REQUIRED AS A RESULT OF MISMANAGEMENT OF SWIFT DURING THE PERIOD IT WAS UNDER GOA CONTROL. THE CASE IS NOW IN THE ARGENTINE COURTS.

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